



April 12, 2006

Ms. Mary Rupp, Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

Re: Part 715 ANPR, Supervisory Committee Audits

Dear Members of the Board:

Thank you for the opportunity to provide comments with respect to the Advance Notice of Proposed Rulemaking as it relates to Supervisory Committees. As requested in the notice, we will provide a response to each question submitted; however the applicability of rules and regulations for public stock based companies and Board appointed audit committees are inconsistent with established governance of credit unions.

The number of responses on this issue should not constitute an overall opinion on how credit unions view this issue, as the response to the notice was very laborious. We would further suggest that the NCUA host regional roundtables to discuss this issue further as the scope and magnitude of this regulation has a significant impact.

Prior to the Sarbanes-Oxley Act there was very little formal governance for public stock based audit committees and their specific responsibilities. Such legislation was necessary to provide specific mandated responsibilities and ensure the soundness of public stock companies with investors. Unlike many public companies, credit unions are subject to periodic outside examinations by regulators that provide another layer of financial soundness.

Several questions and citations in the proposed rulemaking refer to minimum asset size thresholds. Rather than asset size as a criterion for additional regulation, a percent of revenue received from sources outside the credit union could be a consideration and should be explored in-depth. Regulation aimed at a one-size fits all generally does not serve in limiting higher risk activities.

As an industry, strong financial and accountability standards will serve the interest of all members.

Below are our responses to the specific questions:

A. Internal Control Assessment and Attestation

*Q. 1. Should part 715 require, in addition to a financial statement audit, an “attestation on internal controls” over financial reporting above a certain minimum asset size threshold?*

R. We have no knowledge of any systematic financial abuse or mis-reporting of credit unions over a particular size that would warrant additional regulations for an attestation on internal controls. As stated above, rather than asset size, revenues received from outside sources may pose a stronger correlation to financial risk. Current regulations and examinations by both outside auditors and examiners provide sufficient evaluations on the effectiveness of internal controls.

*Q. 2. What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an “attestation on internal controls” over financial reporting, given the additional burden on management and its external auditor?*

R. As stated in response #1, a minimum asset size may not be the best indication for requirement of an attestation on internal controls. If minimum asset size was the only criteria for requiring an attestation on internal controls, our recommendation would be \$5 billion and over. The requirement would be a very costly requirement for credit unions under that asset threshold in both external examination costs and internal resources. It is currently estimated that external auditor costs alone in this area would double, with the additional internal resources that will be required in both time and money being substantial.

*Q. 3. Should the minimum asset size threshold for requiring an “attestation on internal controls” over financial reporting be the same for natural person credit unions and corporate credit unions?*

R. No, since corporate credit unions perform a very different operation than natural person credit unions, a different standard and requirement should be used. Corporate credit unions generally provide a treasury function for an aggregate number of natural person credit unions. Risk of financial failure in this area would be magnified by the number of members at each natural person credit union. The minimum asset threshold, if applied, should be higher for natural person credit unions than for corporate credit unions.

*Q. 4. Should management’s assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, or should it be more narrowly framed to cover only certain types of financial reporting?*

R. The scope should only include financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes.

*Q. 5. Should the same auditor be permitted to perform both the financial statement audit and the “attestation on internal controls” over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the “attestation on internal controls?”*

R. Credit unions should be allowed to engage either a single outside firm or multiple firms in the fulfillment of this requirement as long as independence standards are met.

*Q. 6. If an “attestation on internal controls” were required of credit unions, should it be required annually or less frequently?*

R. In conjunction with the current regulatory examination schedule, the requirement for an attestation on internal controls should be less frequent. We recommend every two years.

*Q. 7. If an “attestation on internal controls” were required of credit unions, when should the requirement become effective?*

R. A minimum of two fiscal periods after the effective date.

#### B. Standards Governing Internal Control Assessments and Attestations

*Q. 8. If credit unions were required to obtain an “attestation on internal controls,” should part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB’s AS 2 standard that applies to public companies, or to the AICPA’s revised AT 501 standard that applies to non-public companies?*

R. If the requirement for an attestation on internal controls was required, the AICPA standard should apply, as this is the most widely accepted standard. The PCAOB’s standard applies to publicly traded companies.

*Q. 9. Should NCUA mandate COSO’s Internal Control – Integrated Framework as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?*

R. The COSO’s standards should apply, as these are the most widely adopted standards and would provide uniformity in application.

#### C. Qualifications of Supervisory Committee Members

*Q. 10. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset size threshold be?*

R. No. A general make up of different expertise should be formulated for a cohesive and effective Supervisory Committee. The only designation for expertise should be for a financial expert. Committee members with different levels of financial experience or disciplines of expertise will strengthen oversight responsibilities. For example, a legal expert with no credit union, banking or financial experience would still be beneficial to the Committee in interpreting key compliance issues.

*Q. 11. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?*

R. No requirement should be mandated for separate outside counsel. In general, the Supervisory Committee would have access to the credit union's general counsel.

*Q. 12. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum asset size threshold?*

R. No. As the Supervisory Committee has an oversight function and not a direct decision making capacity, this regulation would not provide any additional protection. Boards and Supervisory Committees should have strict rules of conduct regarding conflicts of interest and internal dealings.

*Q. 13. If any of the qualifications addressed in questions 10, 11, and 12 above were required of Supervisory Committee members, would credit unions have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers? If so, describe obstacles associated with each qualification.*

R. Yes. Additional qualifications of Supervisory Committee members would further reduce the number of qualified and willing candidates to serve in a voluntary capacity.

#### D. Independence of State-Licensed, Compensated Auditors

*Q. 14. Should a State-licensed, compensated auditor who performs a financial statement audit and/or "internal control attestation" be required to meet just the AICPA's "independence" standards, or should they be required to also meet SEC's "independence" requirements and interpretations?*

R. The auditor should only be required to meet the AICPA's standards of independence as this is the broadest measure and most applicable.

#### E. Audit Options, Reports and Engagements

Q. 15. *Is there value in retaining the “balance sheet audit” in existing §715.7(a) as an audit option for credit unions with less than \$500 million in assets?*

R. Yes. This question is most appropriately answered by a credit union of that size.

Q. 16. *Is there value in retaining the “Supervisory Committee Guide audit” in existing §715.7(c) as an audit option for credit unions with less than \$500 million in assets?*

R. Yes. This question is most appropriately answered by a credit union of that size.

Q. 17. *Should part 715 require credit unions that obtain a financial statement audit and/or an “attestation on internal controls” to forward a copy of the auditor’s report to NCUA? If so, how soon after the audit period-end?*

R. No. The reports should be retained by the credit union for a specific period of time and made available during the examination process. In cases of a non-performing credit union, the examiners could require that reports be forwarded to them as a condition of the exam.

Q. 18. *Should part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union receives it?*

R. No. See answer to question number 17.

Q. 19. *If credit unions were required to forward external auditors’ reports to NCUA, should part 715 require the auditor to review those reports with the Supervisory Committee before forwarding them to NCUA?*

R. Yes. It is imperative that external auditors’ reports are reviewed by the Supervisory Committee, as they are the body that engages the auditors for such a report.

Q. 20. *Existing part 715 requires a credit union’s engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?*

R. The existing delivery date is reasonable. No specific sanctions should be levied on a credit union that completes the report in a reasonable time, however this should be taken into consideration during the examination process.

Q. 21. *Should part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditors dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?*

R. No. The engagement of auditors is between the Supervisory Committee and the auditors. Auditing firms have a responsibility of performing due diligence prior to engaging a client and understanding the reasons when a dismissal or resignation has occurred.

*Q. 22. NCUA recently joined in the final Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters, 71 FR 6847. Should credit union Supervisory Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Supervisory Committees be prohibited from waiving the auditor's punitive damages liability?*

R. Yes. Supervisory Committees should be prohibited into entering into engagements in which the external auditors either limit their liability or waive punitive damages. Additional guidance should be provided to credit unions and external auditors on this topic as our experience has shown that many credit unions are unaware of this.

Thank you again for the opportunity to comment on these issues.

Sincerely,

Steven Stapp  
Executive Vice President/Chief Financial Officer

cc: Brett Martinez, President and CEO  
Redwood Credit Union Board of Directors  
Redwood Credit Union Supervisory Committee